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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 351

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

—v.—

WALTER F. TELLIER and EVELYN H. TELLIER,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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Opinions Below

The unreported memorandum opinion of the Tax Court is reprinted on pages 4a-30a of the printed appendix in the Court of Appeals which was filed in *Tellier* v. *Commissioner,* No. 139, October Term, 1965. The opinion of the Court of Appeals, reprinted in petitioner's Appendix, pages 5-19, is reported at 342 F. 2d 690.

Jurisdiction

The petition correctly states the jurisdictional basis.

Question Presented

When the Commissioner admits that expenditures for a defense against criminal charges are otherwise ordinary and necessary expenses paid in carrying on a trade or business, may he, nevertheless, disallow a deduction for such expenditures for the sole reason that the defense failed?

Statute Involved

The statute involved, Section 162 of the Internal Revenue Code of 1954, is printed on page 2 of the petition.

Statement

Respondent, Walter F. Tellier, was indicted, tried and convicted for violation of 15 U. S. C. 77(q)(a)—the fraud section of the Securities Act of 1933, 18 U. S. C. 1341—the mail fraud statute, and 18 U. S. C. 371—the conspiracy statute, in connection with certain of his acts occurring while he carried on his business as un underwriter for securities offered for sale to the public. During 1956, respondent spent $22,964.20 to defend himself against those charges.

The Commissioner refused to allow any deduction for such defense for the sole reason that respondent had lost the defense. The Tax Court approved the Commissioner's determination, but the Court of Appeals, *en banc,* reversed, refusing to draw a distinction between a successful and an unsuccessful defense against criminal charges, so long as the charges arose out of or were immediately or proximately related to the conduct of a trade or business (Petitioner's Appendix, p. 16).

ARGUMENT

I

The Court of Appeals correctly applied the principle of *Commissioner* v. *Heininger*, 320 U. S. 467 (1943).

Heininger was a licensed dentist, who sold dentures by mail order. He was accused of false and fraudulent mailings. At a departmental hearing, he was deprived of the use of the mails. He fought the order up through the federal courts, but in vain. Thereafter, he deducted the expenses of the litigation on his federal income tax returns. The Commissioner disallowed the deductions.

The only ground on which the Commissioner could support his disallowance was the contention that considerations of public policy dictated the forfeiture of the right to a deduction otherwise clearly allowable as an ordinary and necessary expense of carrying on a trade or business. The Court disagreed. It held that the cost of litigation was not fatally tainted by its remote relation to an act which an administrative agency had determined to be illegal.

In reaching that conclusion, the Court observed that it was not the public policy of the pertinent statutes to deter accused persons from employing counsel for their defense and that a denial of a deduction for the cost of such counsel "would attach a serious punitive consequence" to the administrative finding which Congress has neither expressly nor impliedly indicated should result.

The Tax Court[1] and the Commissioner,[2] however, have advanced the contention that *Heininger* is limited to ad-

[1] *Anthony Cornero Stralla*, 9 T. C. 801, 820-821 (1947).

[2] Rev. Rul. 62-175, 1962-2 C. B. 50.

ministrative findings of unlawful action and has no pertinency to jury verdicts of guilt. The contention produces the anomalous result that a taxpayer may have a deduction for legal fees expended for a defense in a civil proceeding even though he loses, but he forfeits his right to the deduction if the government should successfully proceed criminally on the basis of the very same acts.

That artificial distinction, created by the Tax Court and adopted by the Commissioner, rests solely on the existence of a footnote in the *Heininger* opinion[3] in which this Court had noted that the Second Circuit in *Burroughs Building Material Co.* v. *Commissioner,* 47 F. 2d 178 (2nd Cir. 1931), had previously approved of the disallowance of attorney fees when the taxpayer's defense had failed. The Tax Court contends that the Court had quoted *Burroughs* with approval.

Consequently, the petition for review confronted the Second Circuit with the direct question whether or not *Burroughs* had been overruled by *Heininger.* This is the first time that that narrow issue had arisen in the Second Circuit. For that matter, it is the first time in any Circuit that the facts squarely support a narrow issue of conflict with *Heininger* (p. 6, *infra*).

The Second Circuit could not find any rational basis for a distinction based on the success or failure of a defense or on the identity of the tribunal in which the defense had faltered. It could not find such basis in any decision of this Court and it could not find it in any declaration of public policy. The Second Circuit, therefore, elected to follow *Heininger.*

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[3] *Commissioner* v. *Heininger,* 320 U. S. 467, 473 fn. 8 (1943).

The decision of the Court of Appeals does indeed follow *Heininger;* for just as in *Heininger,* the statutes under which respondent was convicted do not have it for "their policy to deter persons accused of violating their terms from employing counsel to assist in preparing a bona fide defense . . . " and "the deni[al] of the deduction [for the cost of counsel] would attach a serious punitive consequence to the [conviction] which Congress has not expressly or impliedly indicated should result from such [conviction]."

Moreover, as the Chief Judge observed by concurring opinion, the claim that public policy can be said to be hostile to the employment of counsel for a defense is singularly inappropriate today in the circumstances of our present attitudes. Even if *Heininger* were not the law, the reasoning of *Burroughs* could not stand today in the face of those attitudes. As the Chief Judge said,

> . . . the allowance of the deduction here sought is consonant with public policy and ought to be allowed. I think the teaching of *Johnson* v. *Zerbst, supra, Gideon* v. *Wainwright,* 372 U. S. 335 (1963), and the Criminal Justice Act requires this result and that we are no longer bound by *Burroughs.*

It is inconceivable that the Commissioner should contend for a gloss that a taxpayer loses his right to a deduction for his legal costs when he struggles for life or liberty, solely because he has lost, but that he may have the deduction, even though he loses, when he fights for only property. Nevertheless, such is the actual intent of Rev. Ruling 62-175 (*supra*), and such is the only result that can follow from the success of the petition here.

II

There is no conflict with any authority.

The public policy contention is a last-ditch barricade against a deduction. Its assistance is needed only when the Commissioner cannot find a statutory basis for disallowance; that is, when he cannot deny that the expense naturally followed from the operation of the taxpayer's trade or business, or that it was ordinary and necessary in the carrying on of such trade or business. On the other hand, if there is no statutory basis for the deduction of attorney fees, the issue of public policy is irrelevant. *Richard F. Smith,* 31 T. C. 1, 10 (1958), Acq. 1959-1 C. B. 5.

There is a crucial distinction between this controversy and every decision which the Solicitor General has cited as in conflict with the Second Circuit's decision. This controversy is unique in the fact that it is the only one in which the taxpayer has fully passed the test of connection between his expenditures for assistance by counsel and the normal carrying on of his trade or business. This controversy, therefore, is the only one that is completely on all fours with *Heininger,* presenting no question whatsoever but that except for the public policy issue, the expenditures are completely allowable.

As the Court of Claims said in *Port* v. *United States,* 163 F. Supp. 645, 647 (Ct. Cl. 1958):

> The concession which the United States made in *Heininger* is precisely the concession that it refuses to make here, that is, that the present plaintiff's legal expenses proximately resulted from, and were directly

related to his "business" or the "management, conservation, or maintenance of property held for the production of income." Nor do we believe that such a finding by us would be justified.

Both the *Port* case and *Tracy* v. *United States,* 284 F. 2d 379 (Ct. Cl. 1960), which followed, involved attorney fees in defense of charges of filing false and fraudulent personal income tax returns. In the latter case, the Court of Claims specifically refused to base its decision on considerations of public policy. It reaffirmed its reasoning in *Port,* disallowing the deduction only for the lack of relation to the carrying on of a business.

Since the Court of Claims applies the same test of proximate connection, its decisions are in agreement with that by the Second Circuit.

The two Sixth Circuit cases, *Acker* v. *Commissioner,* 258 F. 2d 568 (6th Cir. 1958) and *Hopkins* v. *Commissioner,* 271 F. 2d 166 (6th Cir. 1959), were also cases involving unsuccessful defenses against criminal income tax charges. In the first, the Sixth Circuit, with a bare two paragraph statement, simply approved a decision of the Tax Court (T. C. Memo. 1957-18 (1957), CCH 16 T. C. M. 89) that had ruled that the effect of a prosecution for falsely filing a personal tax return on the taxpayer's business was only incidental; hence, the cost of defense was not a cost of doing business. In the second, the Sixth Circuit referred to its earlier decision as recognizing " . . . the settled rule that legal fees paid by a taxpayer in his defense of an unsuccessful criminal trial for income tax evasion are not deductible" (at 271 F. 2d, pp. 167, 168).

It is therefore not possible to definitely conclude that the Sixth Circuit has developed a clear rule disallowing the cost of an unsuccessful defense against business-connected criminal charges on the basis of public policy. It would seem to be much more correct to say, since its rule was established in a case where the determinative issue was the proximate connection between the taxpayer's business and his filing of fraudulent tax returns, that the Sixth Circuit follows the Court of Claims, and holds that it is not part of a taxpayer's business to file false returns of his income.

Bell v. *Commissioner,* 320 F. 2d 953 (8th Cir. 1963), was another controversy involving prosecution for willful tax evasion. There is absolutely no mention of the public policy issue in the opinion, and the decision is squarely supported by a finding that the expenses were caused by the taxpayer's "personal misconduct" (at 320 F. 2d, p. 958). The Eighth Circuit rested its opinion on proximate cause as did the Second Circuit here.

The two Fourth Circuit opinions, *Estate of MacCrowe* v. *Commissioner,* 240 F. 2d 841 (4th Cir. 1956) and *Peckham* v. *Commissioner,* 327 F. 2d 855 (4th Cir. 1964), are the only non-income tax prosecution cases cited by the Solicitor General. Both involved the prosecution of physicians for criminal abortions.

In the latter (at 327 F. 2d 857), the Court of Appeals said,

> The taxpayer has not sustained the burden of proof that his legal expenses were connected with carrying on his business or profession. . . . In this respect the case differs from *Commissioner* v. *Heininger,* 320 U. S.

467 (1943) where the record did show that the legal expenses were directly connected with carrying on a business.

It is submitted that in no case cited by the Solicitor General was the question of public policy the actual determining factor. On the contrary, the decision in each of the cases really turned on the question of the statutory requirement that the payment be an ordinary and necessary expense of carrying on the taxpayer's business. Since in all opinions, the respective courts insisted on applying the test of proximate cause, which the Second Circuit also applied here, it is evident that all authorities are now in full agreement so far as the applicable principle of law is concerned.

Moreover, no test other than that of proximate cause would be consonant with the Court's decisions which have subsequently clarified the rule in *Heininger*. As the Court said in *Commissioner* v. *Sullivan*, 356 U. S. 27, 29 (1958):

> . . . We said in *Commissioner* v. *Heininger*, 320 U. S. 467, 474, . . . that the "fact that an expenditure bears a remote relation to an illegal act" does not make it nondeductible. . . .
>
> . . . the amounts paid as wages to employees and to the landlord as rent are "ordinary and necessary expenses" in the accepted meaning of the words. That is enough to permit the deduction, unless it is a device to avoid the consequence of violations of a law, as in *Hoover Motor Express Co.* v. *United States, supra*, and *Tank Truck Rentals, Inc.* v. *Commissioner, supra*, or otherwise contravenes the federal policy, expressed in a statute or regulation, as in *Textile Mills Secur. Corp.* v. *Commissioner*. . . .

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be denied.

Respectfully submitted,

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